Latin American Weekly Spotlight

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Argentina:	Renewed tensions in relations with the IMF
Brazil:	Meirelles still under pressure
Chile:	Solid growth in June
Colombia:	Negotiations over fiscal reforms continue
Ecuador:	High oil prices alleviate strain on public finances
Mexico:	Reform of IMSS-pensions completed
Peru:	Unexpected rate hike
Venezuela:	Final countdown

Argentina

As expected, tax revenue in July continued to be up strongly against the same month last year (+34%). However, yoy-growth rates are coming down. ---- Consumer prices rose 0.5% (mom) in July, slightly less than forecast. We expect the yoy rate (July: 4.9%) to rise to 8% by December this year. ---- As was to be expected, the senate passed the fiscal responsibility act. Other reforms agreed upon with the IMF remain behind schedule. ---- The IMF confirmed that the third revision of the current program (prerequisite for further disbursements) will only take place following the two-week IMF recess, which will begin this week. The third and fourth revisions, which look set to be highly contentious again, will most likely both take place in September. Last week, the Argentine government again strongly criticized the IMF position during the crisis in 2001. ---- The Argentine peso last week again depreciated significantly, finishing the week at 3.06 ARS/US$. Since mid-May the currency has been trading at a relatively stable level around 2.95 ARS/US$. The main reason for the recent peso weakness is the decline of export revenues. Latest available figures for June had shown surprisingly weak export growth of 1% (yoy), and seasonal factors will have caused foreign exchange inflows to slow in July. At the same time, the central bank continued to buy US dollars to the tune of US$25mn daily. According to comments from the central bank, this is the main instrument to supply peso liquidity at present. However, the government is probably also happy to foster exports and dampen imports via a peso depreciation. The question is how long this policy can be applied without unleashing inflationary pressure.

<u>Outlook:</u> Following a surprisingly strong decline in consumer confidence in July (-3.8%, mom) the August UTDT Index (Thursday) is likely to show a smaller drop. As GPD growth should come down in the coming months, we expect consumer confidence to gradually decline from its present high level.

Brazil

Imports grew by 36% yoy in July, another sign of the solid economic upturn. As exports grew even more strongly (47% yoy) the trade surplus reached a level of US$ 3.5 bn again. ----- Central bank president Meirelles still under pressure: Now he is suspected of having transferred US$ 50,000 abroad via dubious channels (an allegation which adds to the tax evasion accusations). The accusations certainly have something to do with the municipal elections in October 2004. We do not consider these allegations to be serious enough, and we expect Meirelles to remain in charge. ----- Excellent figures from the industrial sector: According to the IBGE, industrial production increased by 13% yoy. In the coming months we expect further increases in industrial production. First indicators are sales of industrial products, which in July increased by 28% yoy (3.4% mom), according to CNI. In addition, car production rose by almost 40% yoy in July. Finally, capacity utilization is at its highest level since October 1997. Above all, the export-oriented sectors such as the paper and pulp industry as well as the steel sector are producing near capacity (but not the automotive industry). ----- The WTO made a decision with respect to sugar subsidies in favor of Brazil. The decision means that the EU must lower its sugar subsidies significantly. The ruling will enter into force in September or (if the EU challenges it) probably at the start of 2005.

<u>Outlook:</u> After the surprisingly high June IPCA-15 inflation rate, the latest inflation indices showed that the price increases are calming down. We expect an inflation rate IPCA for July of 0.65% mom and 6.54% yoy (Wednesday). ----- Tax revenues are likely to have increased again in July due to the strong economic upturn (forecast: 5% yoy in real terms).

Chile

The IMACEC economic indicator rose by 5% yoy in June. By this, Q2-04 GDP growth amounts to 4.9%, and H1-04 growth to 4.8%. We expect overall 2004 GDP growth to come in at 4.8% as well.

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Outlook: As expected, consumer prices rose by 0.2% mom in July (1.4% yoy). As the increase mainly results from higher transport and energy prices, we expect the CB to leave interest rates unchanged at 1.75% on Thursday's meeting.

Colombia

President Uribe and parliamentarians from various parties announced to convene a commission, which is to work out a compromise with regard to fiscal reforms (above all widening of the VAT base and the pension reform) which have been a source for controversy lately. The commission is planning to come up with results within 15 days. Tensions between the government and some opposition groups in congress seemed to relax somewhat recently. However, last week the government lost the majority of friendly members in the constitutional court (CC), as congress elected an opposition-favorite as a new member. In the past years decisions of the CC caused the downfall of various laws proposed by the government. ----- The government has submitted the 2005 budget to congress. A mutual commission of the senate and the lower house will discuss the budget until the end of October. Until the end of September the budget volume can be altered given the approval of the Ministry of finance. After that only the composition of expenditures can be modified. ------ Because of disappointing export figures (+11% yoy) the trade balance slipped into a slight deficit (US$ -54mn) in May. In the first five months of this year the trade balance posted a deficit of US$ 360mn. ------ Inflation (6.2%) in July was slightly higher than expected (6.1%). On a month on month base consumer prices declined by 0.03%.

Ecuador

Congress has approved a measure that will prevent oil companies from receiving VAT rebates in the future. The decision comes on the back of last month's arbitration court ruling, which ordered the country to refund US$ 75mn in taxes to an American oil company. The government intends to appeal the decision. The considerable legal uncertainty in Ecuador poses a major obstacle for private investment in Ecuador, both local and international. ----- Current high oil prices help to alleviate Ecuador's financing problems: with prices for the Ecuadorian oil mix at almost US$ 36, double the budgeted price, the FEIREP oil stabilization fund is expected to accumulate around US$ 600 mn in 2004. We expect these monies to be used to fund this year's financing deficit, and not, as legally mandated, to buy back external debt. Although this is clearly the wrong approach in the medium term, it will take some strain off public finances in the short run. ----- Unemployment was at 10.5% in June, up 0.5 percentage points compared to June 2003. The feeble labor market is a sign of the weak state of the non-oil economy.

Mexico

Supported by votes from the PAN and PRI, the senate passed a vote to cut future pensions of the social insurance institution IMSS. In the medium to long term, this will help relieve the budget. This reform constitutes a first step toward paving the way for the pension system to be reformed for civil servants as well, among other things. ----- The ministry of finance estimated the level of economic growth at approx. 4% for the second quarter of this year. We are somewhat surprised by this revised forecast, especially since the latest economic indicators of May turned out rather weak: in July, the INEGI consumer confidence index fell by 3.6% M/M and 4.5% Y/Y. This trend is likely to be attributable to a further increase in unemployment in June, among other factors. Moreover, in May the INEGI indicator reflecting future economic activity (*indicador adelantado*) fell by 0.9% month-on-month (April: -0.2% M/M). And finally, in the same month gross investments in capital goods, in seasonally adjusted terms, saw a month-on-month decline over the previous month for the first time in six months, namely by 1.73%. Compared with May 2003, the statistics were still in positive territory, even if the figure, at 2.9%, turned out lower than in April (+5.2%). We adhere to our forecast that GDP will only expand by 3.5% this year. ----- The public-sector budgets finished the first half of the year with a surplus of 56.8 billion pesos, which is equivalent to a decline of 13.5% in real terms. ----- The process of active debt management is being continued. In order to generate funds for early repayment of comparatively expensive loans from the World Bank, the Mexican ministry of finance has reinforced its volume of bonds subject to variable interest rates since early April 2004 (previous volume: US$ 1 billion) by US$ 500 million.

Outlook: industrial output for the month of June (Thursday), at +4%, should turn out higher than in May (+2.1% M/M) on account of the economic trend prevailing in the U.S. ----- The central bank's board of governors will meet on Friday. Against the backdrop of the further increase in inflationary expectations, we anticipate a further tightening of monetary policy.

Peru

The central bank raised the monetary policy interest rate by 25 basis points at its regular board meeting on Thursday. Earlier, remarks by the board had indicated that some members were in favor of delayed rate hikes in order not to endanger the domestic economic upswing. The earlier-than-expected rate hike is clearly positive. We expect that a further appreciation of the sol together with further rate hikes will bring inflation (July 4.6% yoy) below the 3% mark by year-end. ------ The presidents of Peru and Bolivia have issued a mutual letter of intent providing for a toll-free area in the sovereign territory of Peru, from which Bolivian natural gas can be exported. Plans to export natural gas via a Chilean port had caused political unrest during the past several months. ------ The Camisea pipeline is to bring gas to the capital of Lima starting this week. For the time being, only a few industrial plants and one electricity producer are to consume the natural gas. For 2005, plants for exporting the gas are scheduled for construction and in the forthcoming months the distribution of the gas in Peru is to be expanded. ----- President Toledo's approval ratings surprisingly improved somewhat to 13.2% from 9.6% in June. The president has recently agreed to a disclosure of his financial situation, after being accused of embezzling money.

Outlook: The trade balance is to show another strong surplus of around US$ 250mn in June.

Venezuela

Consumer prices in July rose 1.4% MOM, which was less sharply than expected (YOY: 21.8%); this is attributable to the very slight price increases for goods and services subject to state price controls (+0.9% MOM). ----- On the government's initiative, a bill was rushed through parliament to reduce the level of value added tax from 16% to 15%. This measure will enter into force on September 1. For the forthcoming year, a further reduction of this tax is evidently being considered as the tax collection system is reported to have become significantly more efficient. ----- The demand for motor vehicles continues to grow. While the level of demand, at 11,256 vehicles in July, exceeded that of the previous year by 101%, it still remains far behind the record marks of more than 20,000 of 2001. ----- As a result of the bond buyback by PDVSA, which reduced the company's gross debt from US$ 6 billion to US$ 3.4 billion, the country's foreign currency reserves (incl. gold and FEM) declined by US$ 2.5 billion to (a still very good) US$ 21 billion. On account of the ongoing high oil prices, we expect reserves to recover by approx. US$ 2 billion by the end of the year. ----- As announced, the rating agency S&P has reduced its rating for long-term foreign-currency debt of PDVSA Finance from B+ to B since the bonds of the PDVSA subsidiary now are subject to a lower degree of protection. ----- Thanks to the oil bonanza, the figures published by the central bank on the central government's budget for the first five months of this year only show a minor deficit of approx. 1% of GDP even though spending has risen quite substantially in real terms (more than 50% YOY). By the end of the year, the deficit should increase further as a result of the sharp expansion in spending in the run-up to the referendum. On the other hand, the government is using subsidiary budgets for an increasing share of its expenditure (particularly in the case of PDVSA).

Outlook: The preparations for the referendum on August 15 are reaching their decisive phase; this applies in particular to the technical facilities required (electronic vote recording equipment and devices to verify fingerprints). The latest opinion polls indicate that president Chávez is likely to emerge the winner. However, there are also numerous undecided voters. We anticipate an extremely close finish.

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Abbreviations:

mom = month-on-month
qoq = quarter-on-quarter
yoy = year-on-year
s.a. = seasonally adjusted
n.s.a. = not seasonally adjusted

Exchange rate	date	last	one week	one month	one year	end 2003	ytd-change, %	end 2004f
Argentina	06.08.2004	3.06	2.98	2.96	2.92	2.92	-4.6	3.1
Brazil	09.08.2004	3.03	3.05	3.04	3.00	3.00	-0.9	3.1
Mexico	09.08.2004	11.39	11.41	11.49	10.75	10.75	-5.6	11.9
Chile	06.08.2004	641	644	635	703	703	9.6	600
Colombia	09.08.2004	2600	2605	2667	2867	2867	10.3	2800
Peru	06.08.2004	3.41	3.41	3.45	3.48	3.48	2.2	3.5
Venezuela	06.08.2004	1918	1918	1918	1598	1598	-16.7	1918

EMBI+ Spread							
bps	date	last	one week	one month	one year	end 2003	ytd-change, bps
Argentina	09.08.2004	5173	5016	4984	5102	5739	-566
Brazil	09.08.2004	583	593	633	806	463	120
Mexico	09.08.2004	196	199	215	225	199	-3
Colombia	09.08.2004	843	860	940	1226	799	44
Ecuador	09.08.2004	433	445	479	492	431	2
Peru	09.08.2004	392	411	442	452	312	80
Venezuela	09.08.2004	572	583	628	873	593	-21

Benchmark interest rates							ytd-change	
%	date	last	one week	one month	one year	end 2003	%-points	end 2004f
Argentina, Overnight	04.08.2004	2.50	2.50	2.63	2.69	1.50	1.0	3.0
Brazil Selic	06.08.2004	15.84	15.82	15.77	24.36	16.33	-0.5	16.0
Mexico Cetes 28 days	06.08.2004	7.16	7.16	6.66	4.28	6.01	1.2	7.5
Chile 90 days, PDBC	05.08.2004	1.57	1.64	1.56	2.86	2.29	-0.7	2.5
Colombia Overnight	04.08.2004	6.87	6.88	6.84	7.34	7.49	-0.6	8.8
Peru Overnight	06.08.2004	2.50	2.50	2.60	2.83	2.50	0.0	2.6
Venezuela deposits 30 days	03.08.2004	11.90	10.67	11.18	14.41	13.20	-1.3	14.0

Foreign exchange reserves								
US$, bn	date	last	one week	one month	one year	end 2003	ytd-change	end 2004f
Argentina	04.08.2004	18.2	18.1	17.5	13.5	14.1	4.0	18.5
Brazil	05.08.2004	49.5	49.7	49.8	47.7	49.3	0.2	53.2
Mexico	30.07.2004	68.8	68.6	68.5	58.3	65.8	3.0	65.0
Chile	31.07.2004	16.0	na	15.9	15.4	15.9	0.2	16.6
Colombia	30.06.2004	11.6	na	11.4	10.5	10.9	0.7	11.5
Peru	30.06.2004	10.9	na	10.8	10.0	10.2	0.7	11.4
Venezuela (FEM&Gold incl.)	05.08.2004	21.5	23.9	23.2	19.2	21.3	0.2	

Economic activity				Inflation			
GDP (yoy, %)	2003	2004f	2005f	%, year end 2003	2004	2005	GDP 2003, US$ bn
Argentina	8.8	6.5	3.5	3.7	8.0	8.0	127
Brazil	-0.2	3.5	3.5	9.3	6.6	5.9	492
Mexico	1.3	3.5	3.0	4.0	4.2	3.5	626
Chile	3.3	4.8	4.5	1.1	2.5	3.1	72
Colombia	3.7	4.0	3.7	6.5	6.0	6.5	78
Ecuador	2.7	4.8	2.9	3.9	3.2	0.9	27
Peru	4.0	3.8	3.7	1.8	2.5	2.2	61
Venezuela	-9.2	10.5	4.0	27.1	23.5	25.5	82

Public sector	Budget balance, % of GDP		Public debt, % of GDP		Amortization, US$ bn		Gr. financing needs, US$ bn	
	2003	2004f	2003	2004f	2003	2004f	2003	2004f
Argentina	1.3	2.0	140	153	19.8	19.8	19.1	17.7
Brazil*	-5.2	-3.1	58	57	94.2	81.6	72.1	65.7
Mexico**	-0.6	-0.3	28	28	23	29	26	31
Chile***	-0.4	1.2	13	14	0.8	0.8	1.4	0.2
Colombia	-2.8	-2.8	60	60	6.2	5.3	8.4	7.9
Peru	-1.9	-1.6	48	48	1.1	1.5	2.3	2.5
Venezuela	0.2	-3.5	47	41	10.8	4.6	10.7	7.9

* Amortisations only federal debt, including short term debt ** Amortisations without Cetes *** debt, amortization and financing needs: central government only

External Sector 2004f	External debt		Debt service		Current account		Trade Balance	FDI (net)	Import cover
	% of exports	s.t., % of total	US$ bn	% of exports	% of GDP	US$ bn	US$ bn	US$ bn	months
Argentina	373	39	32.3	79	1.5	2.2	10.5	0.0	5.7
Brazil	217	12	67.4	66	1.1	6.1	29.2	11.5	6.4
Mexico	81	28	33.3	17	-1.3	-8.5	-5.9	15.0	3.5
Chile	131	18	6.8	20	2.1	1.8	6.8	1.5	6.1
Colombia	243	12	7.9	49	-1.3	-1.2	0.9	2.0	6.3
Ecuador	17	14	1.4	3	0.3	1.2	6.4	1.0	1.0
Peru	238	16	3.6	26	1.2	0.8	2.6	1.1	9.9
Venezuela	100	9	5.3	16	11.1	10.5	16.5	1.4	11.2